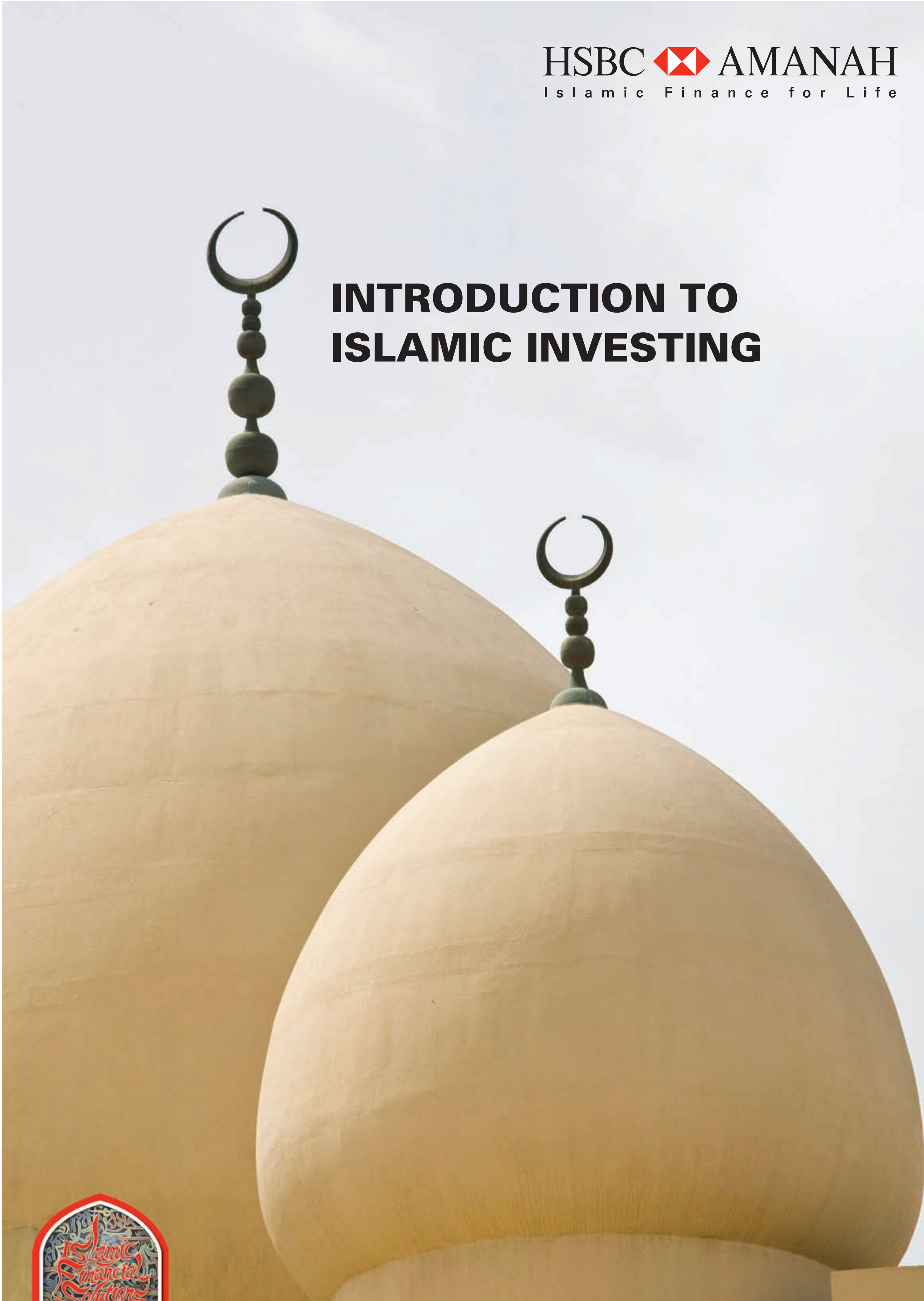
HSBC AMANAH
Islamic Finance for Life



INTRODUCTION TO ISLAMIC INVESTING

hsbcamanah.com





About Shariah Compliant Investments

Assets of Islamic financial institutions have grown by an average of 15-20% per annum* over the past five years, suggesting robust demand for Islamic investing. It is expected Islamic finance will continue to grow at this rate for the next few years as it continues to flourish in the Middle East and the Far East and that total assets in Islamic finance will reach $1 trillion by 2012*.

The growth in Islamic finance has also been mirrored in the growth of Shariah compliant investment funds. It is estimated that currently, there are more than US$30 billion under management* in Shariah compliant investment funds.

Shariah compliant investment funds invest in a wide range of asset classes – equities, real estate, commodities, private equity and infrastructure and the number of Shariah compliant funds worldwide is expected to double by 2010*.

Islamic financial institutions have taken the form of commercial banks, investment banks, investment and financial companies, insurance companies, and financial service companies.

This is an industry that is still evolving, developing and growing. The industry has also grown from retail banking to commercial banking and, more recently, into investment banking. Its sophistication and product offering have developed along with this change.

There is a general perception that Islamic finance is concentrated in the Middle East. While it is true that, at present, about 60% of the total assets of Islamic financial institutions are in the Middle East, Islamic finance is expanding to other Muslim-majority countries. This is primarily because wealth creation and demand for Shariah compliant financial services are making those markets economically viable for financial institutions.

Owing to the oil boom of the 1970s, Islamic banking flourished on the Arabian Peninsula and, from there, expanded into the Middle East and South-East Asia. It is now rapidly developing in Western countries that have large Muslim communities such as in Europe and the United States, with significant activity taking place in London. Islamic banking has already been integrated into the British, French and German banking systems to allow Muslims living in Europe to bank and invest using Shariah compliant products.

Source: HSBC Amanah October 2008 and www. zawya.com

About HSBC Amanah

HSBC Amanah is the Islamic financial services division of the HSBC Group. With experienced personnel working from regional offices, its mission is to ensure that HSBC is the leading provider of value-added Shariah compliant financial products and services to its clients.

HSBC Amanah is uniquely positioned to understand, structure, and deliver financial solutions that are compatible with the requirements of Shariah. It is headquartered in Dubai, and with regional representatives in New York, Riyadh, London, Jakarta and Kuala Lumpur, HSBC Amanah is one of the leading global players in the Islamic finance industry.

HSBC Amanah is guided and supervised by the HSBC Amanah Central Shariah Committee, an independent committee of Islamic scholars. The Committee oversees the development and operations of all HSBC Amanah products and transactions to ensure that they meet the requirements of Shariah.

HSBC Amanah Awards

- **HSBC Amanah** – Best Islamic Fund Manager 2007 (Euromoney)
- **Amanah Saudi Equity Fund** – Best performing GCC Equity Fund over 3-year period (Lipper)
- **Best Islamic Equity Fund** (Amanah Saudi Equity Fund) 2005 (Failaka)
- **Best GCC Equity Fund** (Amanah GCC Equity Fund) 2007 (Failaka)

The Concept

Islamic finance principles embody a unique form of investment management which corresponds with the values of socially responsible investing. Islamic finance is an ethical and equitable mode of finance that derives its principles from the Shariah (Islamic law). The Shariah is based on the Quran (the sacred text of Islam) and the example of Prophet Muhammad, Peace Be Upon Him, (PBUH), and it governs all aspects of personal and collective life of Muslims. The most distinctive element of Islamic finance is the prohibition of interest, whether "nominal" or "excessive," simple or compound, fixed or floating. To comply with Shariah, investment must not involve interest (also known as "Riba").

Islamic investment funds are joint pools wherein investors contribute their surplus funds for the purpose of their investment to earn Halaal ("lawful") profits strict conformity with the precepts of Shariah. Under the principles of Shariah, in addition to prohibition of interest, investment is also disallowed in businesses that deal with alcohol, pork, gambling, tobacco, media, pornography and anything else which is deemed "Haraam" (unlawful). It is also ensured that not only the underlying investments but also the contractual terms agreed between the investors and the investment manager conform to Islamic principles.

All Shariah compliant investments must be certified by experts in Shariah, generally through a panel or board comprised of respected Shariah scholars who are qualified to issue "Fatwas" (religious rulings) on financial transactions. This panel of Shariah experts ensure full compliance of the all Shariah compliant investment funds.

For illustration, the Central Shariah Committee of HSBC Amanah has determined that investment funds investing in equities as an asset class will not invest in companies whose primary business activity is shown in Figure 1 (sectoral screens), or in companies which exhibit characteristics shown in Figure 2 (financial screens).

Islam has disallowed certain contracts due to inherent elements which render them Haraam :

Gharar: Uncertainty. This concept covers particular types of uncertainty or contingency in contracts such as short selling and derivatives.

Maysir: Gambling. Prohibition renders conventional insurance and derivatives Haraam.

Riba: Interest. In simple terms, it covers any financial return on money regardless of whether the interest is fixed or floating, simple or compounded, and at whatever rate.

Figure 1: Sectors	
Alcohol	Weapons
Tobacco	Pork
Financial services	Gambling
Pornography	Leisure/media

Figure 2: Financial All the following should be less than 33%
Total Debt/12 month trailing market capitalisation
Cash & Interest bearing securities/12 month trailing market capitalisation
Accounts Receivable/12 month trailing market capitalisation

Central Shariah Committee

All Shariah compliant investments must be certified by experts in Shariah, generally through a panel or board comprised of respected Shariah scholars who are qualified to issue "Fatwas" (religious rulings) on financial transactions. This panel of Shariah experts ensure full compliance of all Shariah compliant investment funds.

Three scholars of international repute, well versed in both Islamic law and modern finance, serve on the HSBC Amanah Shariah Committee. The Committee not only provides initial approvals on investment objectives and investment strategy of all funds, but also reviews the investments periodically to ensure the continuous compliance of the investments of the funds to Islamic principles. Moreover, the Committee conducts annual audits of all funds to ensure adherence to their rulings during the year.

Sheikh Nizam Yaquby

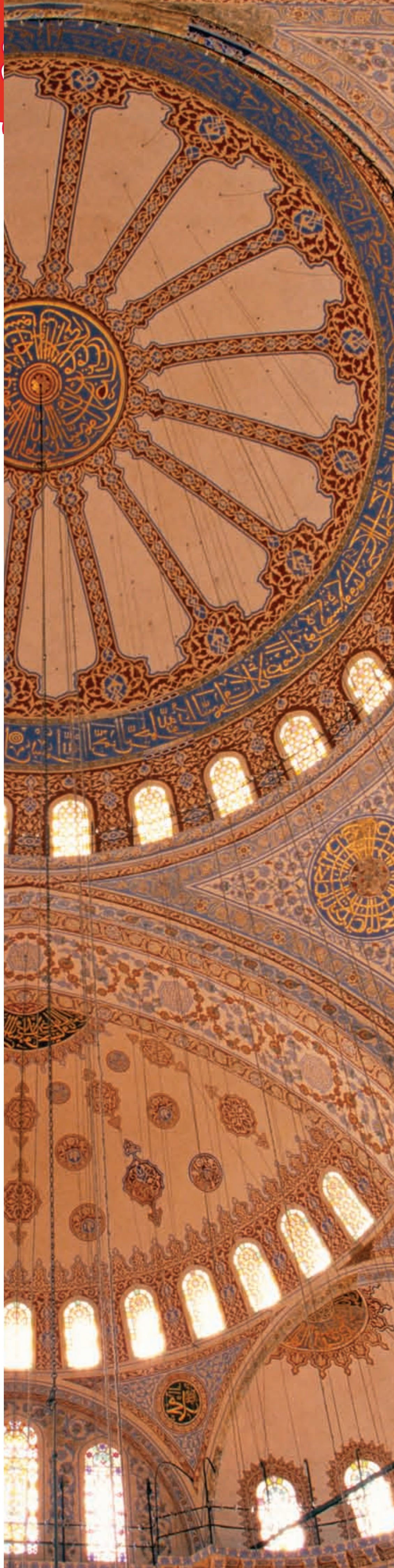
He is a graduate in economics and comparative religion from McGill University and is an internationally acclaimed scholar in the islamic banking industry. He has been a teacher of Tafsir since 1976. He advises a number of banks and financial institutions including BNP Paribas, Dow Jones, Lloyds TSB and Standard Chartered on islamic banking and finance.

Sheikh Dr Mohamed Elgari

Holds a PhD in economics from the University of California. He is a Professor of Islamic Economics and the director of the Centre for Research in Islamic Economics at King Abdulaziz University in Saudi Arabia. He is an expert at the Islamic Jurisprudence Academy (OIC), Jeddah. Dr Elgari is the editor of the Review of Islamic Economics. He is also an adviser to several Islamic financial institutions worldwide and the author of many books on Islamic banking.

Dr Mohamed Imran Ashraf Usmani

Holds a PhD in Islamic Finance. He also obtained degrees of Alimiyyah and Takhassus (specialisation in Islamic Jurisprudence) from Jamia Darul Uloom, Karachi. His area of expertise is Islamic Finance in which he has carried out extensive research. Dr. Usmani is a faculty member/teacher of Jamia Darul Uloom, Karachi and Institute of Business Administration (IBA), Karachi. He is the author of various books on Shariah (Islamic lawfrom Jamia Darul Uloom, Karachi. His area of expertise is Islamic Finance in which he has carried out extensive research. Dr. Usmani is a faculty member/teacher of Jamia Darul Uloom, Karachi and Institute of Business Administration (IBA), Karachi. He is the author of various books on Shariah (Islamic law).





Financial Instruments

The most common forms of Shariah compliant investment funds are equity funds, real estate funds and money market Funds. These investment funds employ Islamic contracts which ensure that the terms and rights of all parties are safeguarded in conformity with Islamic principles (examples and definitions are given below).

Musharakah: A partnership where profits are shared according to a pre-agreed ratio while losses are shared in proportion to the capital investment of each partner. This equity financing arrangement is widely regarded as the purest form of Islamic financing.

Mudarabah: An investment partnership under which the investor (the "Rab-ul-Mal") provides capital to the investment manager (the "Mudarib") in order to undertake a business or an investment activity. While profits are shared on a pre-agreed ratio, losses are borne only by the investor.

Ijarah: An Islamic lease agreement. Instead of lending money and earning interest, Ijarah allows the investor to earn profits by charging rentals on the asset leased to the user.

Murabaha: Purchase and resale of an asset. Instead of lending money, the investor purchases the desired asset from a third party and resells it at a predetermined higher price to the user. By paying this higher price over instalments, the user of the asset has effectively obtained credit without paying interest.

The classical equity instruments in Islamic commercial law (musharakah and mudarabah) require partnership and profit sharing. In financial markets, investing in stocks and equity funds is permitted but must conform to certain guidelines.

Conventional interest-based lending or bonds are ruled out in Islamic finance because it relies on interest. Instead, asset-backed financing is encouraged with the risk being shared by the provider and the user of the asset.

Glossary

Amanah: Trust, with associated meanings of trustworthiness, faithfulness and honesty. As an important secondary meaning, the term also identifies a transaction where one party keeps another's funds or property in trust. This is in fact the most widely understood and used application of the term, and has a long history of use in Islamic commercial law. By extension, the term can also be used to describe different financial or commercial activities such as deposit taking, custody or goods on consignment.

Arbun: Earnest money/Down payment; a non-refundable deposit paid by the client (buyer) to the seller upon concluding a contract of sale, with the provision that the contract will be completed during the prescribed period.

Gharar: Uncertainty. One of three fundamental prohibitions in Islamic finance (the other two being riba and maysir). Gharar is a sophisticated concept that covers certain types of uncertainty or contingency in a contract. The prohibition on gharar is the basis for disallowing practices such as short selling, speculation and derivatives.

Islamic banking: Financial services that meet the requirements of the Shariah, or Islamic law. While designed to meet the specific religious requirements of Muslim customers, Islamic banking is not restricted to Muslims: both the financial services provider and the customer can be non-Muslim as well as Muslim. Also called Islamic finance or Islamic financial services.

Ijarah: An Islamic lease agreement. Instead of lending money and earning interest, Ijarah allows the bank to earn profits by charging rentals on the asset leased to the customer. Ijarah wa iqtinah extends the concept of ijarah to a hire and purchase agreement.

Istisna: A contractual agreement for manufacturing goods (commodities), allowing cash payment in advance and future delivery or future payment and future delivery (based on agreed terms).

Maysir: Gambling. An ancient Arabian game of chance played with arrows for sake of slaughtered and quartered camels. It came to be identified with all types of gambling and is one of three fundamental prohibitions in Islamic finance (the other two being riba and gharar). The prohibition on maysir is the basis for disallowing practices such as speculation, conventional insurance and derivatives.

Mudarabah: A Mudarabah is an Investment partnership, whereby the investor (the Rab ul Mal) provides capital to another party/entrepreneur (the Mudarib) in order to undertake a business/investment activity. While profits are shared on a pre-agreed ratio, loss of investment is born by the investor only. The mudarib loses its share of the expected income.

Mudarib: The mudarib is the entrepreneur or investment manager in a mudarabah who invests the investor's funds in a project or portfolio in exchange for a share of the profits. For example, a mudarabah is essentially similar to a diversified pool of assets held in a Discretionary Asset Management Portfolio.

Murabaha: Purchase and resale. Instead of lending out money, the capital provider purchases the desired commodity (for which the loan would have been taken out) from a third party and resells it at a predetermined higher price to the capital user. By paying this higher price over installments, the capital user has effectively obtained credit without paying interest.

Musharakah: Profit and loss sharing. It is a partnership where profits are shared as per an agreed ratio whereas the losses are shared in proportion to the capital/investment of each partner. In a Musharakah, all partners to a business undertaking contribute funds and have the right, but not the obligation, to exercise executive powers in that project, which is similar to a conventional partnership structure and the holding of voting stock in a limited company. This equity financing arrangement is widely regarded as the purest form of Islamic financing.

Riba: Interest. The legal notion extends beyond just interest, but in simple terms riba covers any return of money on money - whether the interest is fixed or floating, simple or compounded, and at whatever the rate. Riba is strictly prohibited in accordance with the Islamic tradition.

Shariah: Shariah or Islamic refers to divine guidance as given by the Holy Quran and the Sunnah (practice) of the Prophet Muhammad (Peace Be Upon Him) and embodies all aspects of the Islamic Faith, including beliefs and practice.

Shariah compliant: An act or activity that complies with the requirements of the Shariah, or Islamic law. The term is often used in the Islamic banking industry as a synonym for "Islamic" for example, Shariah compliant financing or Shariah compliant investment.

Sukuk: Similar characteristics to that of a conventional bond with the difference being that they are asset-backed, a sukuk represents proportionate beneficial ownership in the underlying asset. The asset will be leased to the client to yield the return on the sukuk.

Takaful: Islamic insurance. Structured as charitable collective pool of funds based on the idea of mutual assistance, takaful schemes are designed to avoid the elements of conventional insurance (interest and gambling).